HOGAN & HARTSON L.L.P.

MEMORANDUM FOR
THE CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM

Washington Monthly Report

Mandatory Social Security

Congressional efforts to restore the long-term solvency of the Social Security trust fund should take a step forward later this month or early next month with the expected release of the proposal drafted by House Ways and Means Social Security Subcommittee Chairman Clay Shaw (R-Fla.) and House Ways and Means Committee Chairman Bill Archer (R-Tex.).

The Shaw-Archer proposal is expected to incorporate a private accounts feature, but details have been very closely held as the finishing touches are applied to the proposal. Reportedly, the mechanism for financing the proposal has been the most nettlesome issue. The budget surpluses apparently will serve as the principal source of financing for the private accounts, but the precise means still is unclear. The indications continue to be that mandatory Social Security coverage for new State and local government workers will **not** be part of this initial Shaw-Archer package.

The Shaw-Archer proposal would be the first step in what would likely be a long and tortuous debate on Social Security reform in the House. Subcommittee Chairman Shaw and full Committee Chairman Archer have not laid out their strategy or timing for consideration of their proposal. Subcommittee Chairman Shaw recently indicated that the proposal would be presented first in concept, with legislative language to follow sometime later. Thus far, House Republicans have appeared to adopt the approach of "going it alone", with Shaw and Archer drafting the proposal without input from House Democrats or the Administration. Chairman Archer had made some preliminary contacts with Senators Bob Kerrey (D-Neb.) and Daniel Patrick Moynihan (D-N.Y.) who have been among the most aggressive advocates of Social Security reform in the Senate. However, these preliminary contacts do not seem to have developed into bipartisan cooperation.

It remains to be seen whether Ways and Means Chairman Archer and Subcommittee Chairman Shaw would attempt to move their package through the Ways and Means Committee without support of at least some Democrats. Because Republicans hold a "supermajority" on the Ways and Means Committee, the legislation could be moved through the Committee on a straight party line vote.

However, the measure then would face the full House where the GOP holds a slim five-seat majority. Thus, it would be quite difficult to ram Social Security reform proposal through the House on a purely partisan basis. Chairman Archer has indicated for now that he will wait to see how the Administration reacts before moving forward with the proposal, noting that "We can't move here unless we have some degree of receptivity from the White House." The Administration has its own version of individual accounts, dubbed Universal Savings Accounts (USA), in which workers earning below $100,000 would receive an automatic government contribution of $300 per person with an additional government match of up to $350 for voluntary, after-tax contributions made by the worker.

Over in the Senate, protecting the long-term solvency of the Medicare system is beginning to overtake Social Security solvency in priority, at least in the eyes of Senate Finance Committee Chairman Bill Roth (R-Del.). This could further affect the overall momentum for Social Security reform.

While the macro picture begins to unfold on Social Security reform, we have continued to actively work on the mandatory State and local coverage issue, coordinating with STRS staff on the grassroots activity in California, staying in touch with key Members of the California Congressional delegation, coordinating with interested California groups having a Washington presence, and coordinating with the network of national groups of State and local government employers and employees.

California is at the forefront of grassroots activity on the mandatory coverage issue. However, it appears that a significant number of the other States with substantial non-covered State and local workers have been slow to gear up their grassroots efforts with respect to their Congressional delegation. As we reported last month, Senator Feinstein and Senator George Voinovich (R-Ohio), a freshman Senator and the former Governor of Ohio, have been seeking signatures from their Senate colleagues on a letter to the President urging him to exclude mandatory coverage from any Social Security reform package he proposes. So far, the results have been disappointing. We understand that the letter presently has only four other signatories, Senator Boxer; the two Colorado Senators, Wayne Allard and Ben Nighthorse Campbell; and one of the Missouri Senators, John Ashcroft. We will be doing what we can through the national groups to put the word out on the Voinovich-Feinstein letter, as well as encouraging the Coalition to Preserve Retirement Security to energize its grassroots members.

The attacks on State and local government plan investment policy and performance seem to have largely run their course, at least for now, in the context of the broader debate over Social Security reform. The aggressive defense by the State and local government community of public plan management and performance seems to have had a real impact in beating down the misimpression that public plans are underperforming, politicized operations. Reportedly, there is even some new scholarship underway that takes a fresh look at the matter.

However, we have not likely heard the end of this issue, as the release of a House GOP plan with a private accounts feature (coupled with release of the SEC's forthcoming "pay-to-play" restrictions on campaign contributions by investment managers of public pension plans) could lead to a renewed focus on State and local plan practices if the Administration vigorously pursues its direct investment alternative. Nonetheless, the public record on public plan management and investment performance is now more balanced with the data provided by the State and local groups showing comparable private plan and public plan investment performance.

We understand that the House Ways and Means Social Security Subcommittee is considering holding another hearing on the implications of Social Security reform for State and local government plans, as well as for the Federal plan. Details remain sketchy. We are pursuing this matter.

We will be continuing to actively work with the California Congressional delegation and to coordinate with the national groups on the mandatory coverage issue in the weeks ahead.

On the offset front, Sen. Barbara Mikulski has reintroduced her "Government Pension Offset Reform Act" (S. 717) to address the concern over the reduction of the Social Security spousal benefit for a surviving spouse who also receives a Federal, State, or local government pension. This legislation is a double-edged sword because proponents of mandatory Social Security are quick to point out that bringing State and local workers into Social Security solves the offset problem.

Elk Hills Compensation

Well, the check has cleared. STRS now has $36 million more in compensation from Elk Hills than many people inside and outside of government ever thought we'd receive. This was the first of seven annual installments due STRS under the $320 million Elk Hills settlement.

President Kennedy once observed that, "Victory has a thousand fathers, and defeat is an orphan." We understand that the Department of Energy -- which had to be gently persuaded to come to the settlement table and then to actually reach a settlement -- now views itself as one of those fathers and that Secretary of Energy Bill Richardson will be traveling to San Francisco to memorialize the first settlement payment. We would welcome the energetic support of the Secretary of Energy in the appropriations battle for the coming fiscal year to seek the next $36 million annual installment.

Sight should not be lost here that it was really Rep. Bill Thomas (R-Bakersfield) who in the end delivered the $36 million Elk Hills appropriation, with the valuable assistance of the White House Chief of Staff during the high-level negotiations over the huge omnibus appropriations package at the end of the last Congress.

There is the matter, of course, of the next $36 million installment of compensation due for FY 2000. We hope that Secretary Richardson and the Administration will actively assist us in securing the necessary $36 million Congressional appropriation As we reported earlier, the appropriations battle is likely to be even tougher this year now that the Republican Leadership in Congress has chosen to adhere to the current law caps on discretionary Federal spending. These caps will ratchet down for FY 2000 to levels that are significantly below last year's levels. It remains to be seen whether the revised Congressional Budget Office forecast of the projected budget surplus, expected in June or July, will be adjusted upward sufficiently to provide Congressional leaders with additional spending flexibility with respect to the budget caps. Even these potential gains risk being dissipated in a field in Kosovo.

The House Appropriations leadership has received and is now well aware of the letter from the entire California House delegation in support of the appropriation for the next $36 million installment of Elk Hills compensation. However, we still face the very difficult budget hurdle of competing with ongoing programs, such as national parks, for an even more limited pot of spending.

Pension Liberalization Legislation

Senators Bob Graham (D-Fla.) and Charles Grassley (R-Iowa) have introduced the Senate companion legislation to the comprehensive pension reform and liberalization legislation introduced last month in the House. The House legislation, known as the Comprehensive Retirement Security and Pension Reform Act (H.R. 1102), was introduced by Reps. Rob Portman (R-Ohio) and Ben Cardin (D-Md.) and outlined in last month's report. The Graham-Grassley Senate counterpart (S. 741) is known as the Pension Coverage and Portability Act.

The Graham-Grassley measure is generally similar to the Portman-Cardin proposal, especially with respect to the provisions intended to facilitate portability in the public plan sector. The Graham-Grassley measure would increase the current law limits on benefits and contributions under retirement plans, as did the Portman-Cardin measure, but not by as much. The Graham-Grassley measure would increase the dollar limit on benefits of defined benefit plans to $160,000, rather than $180,000 as under Portman-Cardin. The amount of compensation that could be taken into account in computing benefits would be increased under Graham-Grassley to $200,000, as compared to $235,000 under Portman-Cardin. Graham-Grassley would increase the elective deferral limits under section 403(b) and section 401(k) plans to $12,000 and under section 457 plans to $10,000, as compared with $15,000 for section 403(b) plans, section 457 plans, and section 401(k) plans under the Portman-Cardin legislation.

The House Ways and Means Oversight Subcommittee held a hearing on the Portman-Cardin pension liberalization legislation on March 23. The National Council on Teacher Retirement, the National Association of State Retirement Administrators, the National Council of Public Employee Retirement Systems, and the Government Finance Officers Association testified jointly in support of the Portman-Cardin legislation, particularly the portability provisions for public sector plans.

The prospects of the public sector portability and other provisions of the Portman-Cardin legislation are likely to depend on the fate of overall tax legislation this year is expected to be taken up by the House Ways and Means and Senate Finance Committees in July.

This Ways and Means tax package is likely to include at least some of the more popular and less costly provisions of the Portman-Cardin legislation. Particularly if the Social Security solvency effort becomes bogged down, the Congressional Republicans will be under pressure to show a track record of promoting retirement savings. If the past is any guide, the Portman-Cardin package will be “cannibalized” for provisions that are viewed as “doable” this year. The advantage of the public sector portability provisions is that they have broad bipartisan support and are not costly. The fate of an overall tax package will depend on the “macro” budget picture shaping up at the end of the summer between Congress and the Administration.

SEC of “Pay-to-Play” Regulation of Campaign Contributions by Investment Managers

The Securities and Exchange Commission is preparing to issue new rules barring campaign contributions by investment managers to public officials who are viewed as having control or influence over the management and investments of public pension plans. Reportedly, the forthcoming SEC guidance will extend even to public officials, such as the Governor, who hold merely appointive authority over the governing body of the public retirement plan.

We understand that the National Association of State Treasurers and the Government Finance Officers Association are actively opposing this SEC rulemaking effort, especially given its broad scope. The message is that the system of disclosure and accountability under State law works. Reportedly, the SEC staff is dug in on this forthcoming rulemaking and have challenged the public plan community to demonstrate why such SEC regulation is not in fact necessary.

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